Mexico

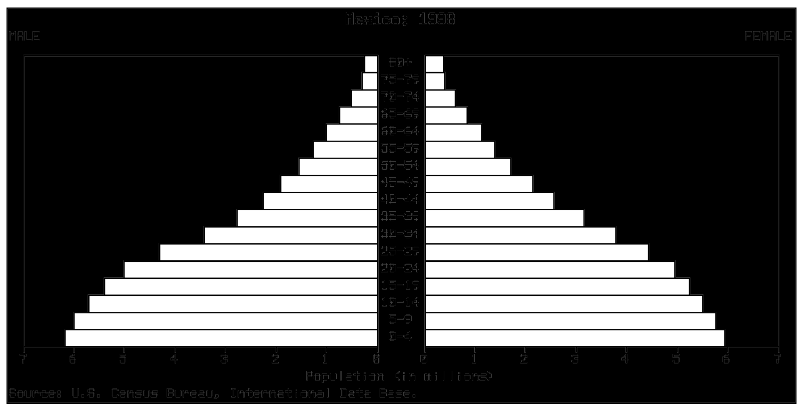
Summary of Current System			
	Pillar 1	**Pillar 2**	**Pillar 3**
Type:		♦ Defined-contribution	♦ Defined-contribution
Participation:		♦ Mandatory	♦ Voluntary
Management:		♦ Privately-managed	♦ Privately-managed
Financing:		♦ Fully-funded	♦ Fully-funded
Coverage:		♦ All employees entering labor force after July 1997 and participating self-employed workers	♦ Individual employees
Eligibility:		♦ 65 years for men and women and fulfilled minimum contributions	♦ 65 years for men and women and fulfilled minimum contributions

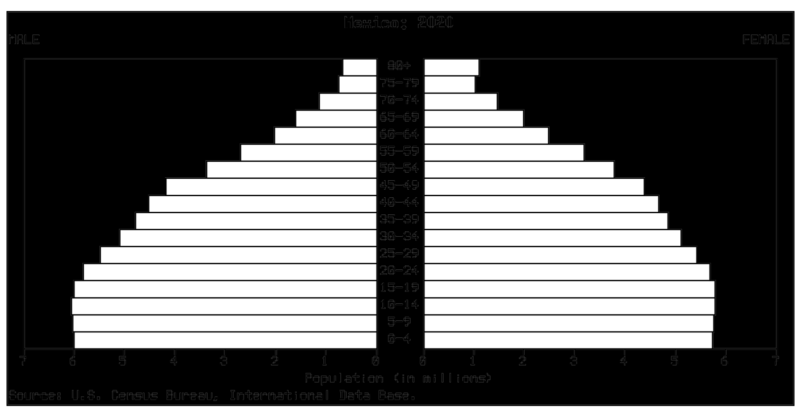
Problems Leading to Pension Reform

- ❑ Contribution evasion
- ❑ Generous benefits
- ❑ Demographic shifts

Summary of Current Pension System

The legislation enacting the current pension system in Mexico took effect in July 1997. It shifted the pension system from a defined-benefit to a defined-contribution system and closed the pay-as-you-go (PAYGO) system to new workers. The new system is based on privately-managed individual accounts (in Pillar II), which is mandatory for all private sector employees. Furthermore, the reformed system strengthened and improved the *Sistema de Ahorro para el Retiro* (SAR), a fully-funded pension system that complemented the old PAYGO system.





In contrast to the old pension system, this new system distinguishes between old age, health, and disability benefits, as separate funds have been established for them. Funding comes from employer, employee and government contributions, where the total contribution rate is between 16.5 percent and 21.0 percent.

Individual retirement funds (SIEFORES) are managed by investment firms, *Administradoros de Fondos de Retiro* or AFORES. It contains three sub-accounts: (1) old and severance insurance; (2) specialized housing; (3) voluntary contributions. The contribution rate of 8.5 percent in the old system which covered retirement and disability benefits has been divided into the following: 4.5 percent is placed in individual accounts; 2.5 percent will finance life and disability insurance; and, 1.5 percent covers health care. In addition, the contributions that were formerly made to the SAR are placed in individual retirement funds. This amounted to 7 percent, where 2 percent was allocated for retirement and 5 percent for housing. The government also contributes an equivalent of 5.5 percent of the minimum wage (about 2 percent of average wage) as of January 1997, which will be indexed to inflation. Employees may increase their savings by contributing additional funds.

Mexico

SELECTED INDICATORS		
	Year	
Demographic	*1998*	*2020*
Total Population (in thousands)	98,562	134,387
Life Expectancy at Birth (Years)	71.63	77.83
Total Fertility Rate (Child Born per Woman)	2.91	2.19
Age Dependency Ratio	10.8	16.8
	1980-2000	*2000-2020*
Average Annual Rate of Population Growth (percent)	2.0	1.4

Source: U.S. Bureau of the Census. International Data Base.

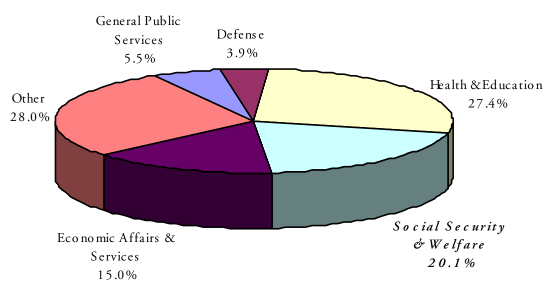
Economic	*1996*
GNP (PPP in billions)[1]	713.8
GNP Average Annual Growth Rate, 1995-1996 (percent)[1]	6.6
GNP Per Capita (in PPP)[1]	7,660
Inflation Rate (percent)[2]	34.4
Labor Force Participation Rate (percent)[3]	40.0
Unemployment Rate (percent)[3]	3.7

Source: [1]World Bank; [2]IMF; [3]International Labour Office.

Pension	*1997*
System Dependency Ratio (percent)[1]	12.5
Employee Contribution for Pensions (percent of earnings)[2]	2.125
Employer Contribution for Pensions (percent of payroll)[2]	12.95
Public Pension Spending as % of Government Spending	n/a
Public Pension Spending as % of GDP, 1996	n/a

Source: [1]World Bank; [2]Sales-Sarrapy, et al (1996).

GOVERNMENT SPENDING BY SECTOR, 1995



Source: International Monetary Fund. Government Finance Statistics Book, 1997.

Eligibility occurs when an individual has reached 65 years and has contributed at least 25 years. Pensions for workers affiliated with the new system are based on their account balance. Transition workers however must choose between the pension under the old system or the balance on their individual account. Those choosing the public pension option must surrender any balance. These transition rules differ from other countries where workers who choose the public pension option receive compensation for their previous contributions.

The third pillar in the pension system is voluntary occupational plans. Employers provide either defined-benefit or defined-contribution plans. There are approximately 8,000 voluntary occupational plans 30 to 35 large enterprises.

Problems Leading to Pension Reform

Although established as a partially-funded pension system, the Social Security Institute tended to use surpluses to finance other social insurance benefits. In an effort to contain the deficit, a mandatory fully-funded system based on individual accounts (called SAR) was introduced in 1992. By 1994, the lack of a regulatory agency and issues such as poor administration, inadequate monitoring and supervision of accounts underscored the need for reform. Contributions to the SAR ceased by July 1997.

The financial difficulties of the pension system stemmed from many factors. The deficit was estimated to be more than 100 percent of GDP in 1994. The pension system experienced low participation rates as employers and employees evaded contributions or under-reported earnings. The eligibility rules also resulted in workers contributing for the minimum vesting period of 10 years; they however received benefits equal to those who contributed for 17 years.

Economic and demographic factors also contributed to the initiation of reform efforts. Social security expenditures increased from $11 million in 1989 to $49 million in 1994. High inflation rates from 1980 to 1994 caused a 60 percent decrease in real wages and a significant decline in the value of pension benefits in real terms. By 1990, Mexico experienced decreases in population growth and lower mortality rates. In addition, changes in life expectancy and lower fertility rates will increase the proportion of individuals 65+ years to 10 percent by 2020. This resulted an increase in the dependency ratio from 4 percent in 1960 to 13 percent in 1994.

Current Pension Reform Efforts

Under the new pension system, 64 percent of eligible individuals affiliated with one of 17 AFORES. In an attempt to reinforce the reform efforts, the National Commission for the Retirement Saving System (CONSAR) gained control over the AFORES, the SIEFORES and other financial institutions. Regulations have been designed by CONSAR to protect employees and encourage investment. Workers will only be permitted to alternate between funds after one year of participation. Mandatory contributions must also remain in the account until the individual is eligible to retire.

Pension Reform Efforts by Pillar

	Pillar 1	Pillar 2	Pillar 3
Papers issued on state of pension systems	✓	✓	✓
Formulation of proposals	✓	✓	✓
Development of draft legislation	✓	✓	✓
Introduction of legislation by parliament	✓	✓	✓
Review of legislation by parliament	✓	✓	✓
Passage of legislation by parliament		✓	✓
Implementation of legislation			